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KEY ECONOMIC INDICATORS

(millions of U.S. dollars unless specified)

Domestic Economy	1986	1987	1988	1989*
Population (millions)	7.7	7.98	8.28	8.58
GDP	1178.6	1247.3	1445.0	1703.4
GNP	1117.5	1190.4	1389.0	1644.7
GDP per capita	153	156	175	199
GDP in Malawi Kwacha (1978=100) % change	1.1	1.5	3.6	4.6
Consumer price index % change	15.0	26.5	31.5	26.2**
Production and Employment				
Private employment ('000)	343.5	316.4	N/A	N/A
Public employment ('000)	84.3	91.0	N/A	N/A
Industrial production % change (Local Currency Base 1984=100)	2.4	-4.9	6.5	4.9
Gov't Deficit (% of GDP)	-13.9	-8.7	-5.5	-6.3
Balance of Payments				
Exports (f o b)	248.5	278.4	297.1	292.8
Imports (f.o.b.)	154.2	177.5	242.7	266.2
Trade balance	94.2	100.9	54.4	26.6
Current account balance	-67.9	-59.4	-104.9	-198.5
External debt (Millions SDR)	845.1	872.6	915.0	1001.5
Debt-Service Ratio	56.9	45.8	25.5	28.3
Foreign Exchange Reserves	24.6	51.8	145.6	131.0**
Average Exchange Rate (Kwacha per US$1)	1.86	2.21	2.56	2.63**
U S.- Malawi Trade and Investment				
U.S. Exports (f.a.s.)	2.8	4.9	12.4	1.5**
U.S. Imports (c.i.f.)	22.2	27.1	41.2	12.4**
U.S. Investment (cumulative)	5.4	5.4	6.2	6.2
U.S. Assistance				
Bilateral development	24.0	10.8	21.4	17.0
Regional development	11.1	0.5	16.0	0.3
Food	0.4	6.3	14.1	13.0
Military (MAP/IMET)	0.3	2.2	0.7	0.8

Principal U.S. exports (1988): Wheat, Corn, Electrical Components, Office Equipment, Tobacco, Paper.
Principal U.S. imports (1988): Tobacco, Sugar, Textiles, Macadamia Nuts.

*Forecast
**Through April 1989

Sources: National Statistical Office, IMF, World Bank, Reserve Bank of Malawi.

SUMMARY

Malawi is a landlocked country in southeastern Africa of 37,000 square miles -- about the size of Pennsylvania. With an estimated 1988 per capita GDP of $175 and a population of 8.3 million, Malawi ranks among the world's least developed countries. Approximately 85 percent of Malawi's work force is engaged in agriculture, accounting for 37 percent of GDP and 92 percent of export earnings in 1988. Real GDP growth in 1988 was 3.6 percent, with 4.6 percent growth anticipated in 1989. This is a sharp improvement over sluggish growth of 1.1 percent and 1.5 percent in 1986 and 1987, respectively.

Malawi has relied upon a successful agricultural sector as the primary engine for development since independence in 1964. Normally self-sufficient in staple food production given favorable climatic conditions, Malawi also produces tobacco, tea, sugar, groundnuts, coffee, and cotton. However, drought and mealy bug infestation in 1987, and a burgeoning refugee population (650,000 in April 1989), combined to virtually eliminate Malawi's 180,000 ton grain reserve. The reserve had allowed Malawi to export maize to neighboring countries in the past.

Malawi's terms of trade have deteriorated over the past decade, as the prices of its principal agricultural exports have lagged behind steadily rising import costs. Malawi has followed several World Bank structural adjustment programs since the early 1980s with some success, and most recently rescheduled its external debt in 1988.

The biggest single factor affecting Malawi's terms of trade has been the sharp rise in transportation costs due to the continued closure of the rail links through Mozambique to ports on the Indian Ocean and the resulting lengthy transportation routes through South Africa and Tanzania. The threat of sanctions against South Africa by Front Line States and the possibility of counter-sanctions would, if implemented, pose serious difficulties for Malawi.

Over the next several years, Malawi's ability to import will depend largely upon hard currency earnings from its major exports (tobacco, tea, sugar, and coffee), external aid flows, and success in maintaining reliable and cheaper transportation routes. At the moment, Malawi enjoys rising commodity prices, adequate aid flows, and functional transportation routes. There is optimism in the local economy that the situation will continue to improve. Reopening of rail routes through Mozambique would have a major positive impact.

PART A - CURRENT ECONOMIC SITUATION AND TRENDS

Real GDP grew by 3.6 percent in 1988, after sluggish growth of 1.5 percent in 1987. All sectors, with the exception of distribution, showed substantial expansion. Driving economic growth in 1988 were the renewed availability of foreign exchange, strengthened international agricultural commodity prices, continued world economic growth, and increased production of maize and tobacco. Real GDP is forecast to grow by 4.6 percent in 1989, based on expectations of higher capacity utilization by industry and increased agricultural production. One dark spot has been the continued high inflation rate of 32 percent in 1988. By January 1989 inflation had dropped to 26 percent, but the Government of Malawi (GOM) hopes to reduce inflation to 12.5 percent by the end of 1989.

In general, business confidence is bullish, as the renewed availability of foreign exchange has allowed the business community to repair capital equipment and import commodities unavailable in Malawi. However, the current economic recovery rests upon a foundation Malawi can do little to control, i.e, external transportation routes, world agricultural commodity prices, and the weather. Clearly, one aspect of the recovery is donor confidence in Malawi and the substantial accompanying aid flows which, in part, fuel the current expansion.

BALANCE OF PAYMENTS: Malawi's positive merchandise trade balance of $54.4 million (down from $100.9 million in 1987) was overtaken by the continued high cost of international transportation. Calculated on a C.I.F. basis, the trade balance posted a $107 million deficit. Accordingly, the current account showed substantial deficits of $59 million in 1987 and $105 million in 1988. However, Malawi continued to enjoy a substantial surplus on its capital account, which rose from $85 million in 1987 to $141 million in 1988. This rise reflects the large capital inflows from the World Bank's Industrial and Trade Policy Adjustment Credit (ITPAC), the International Monetary Fund's (IMF) Enhanced Structural Adjustment Facility (ESAF), and other donor financing. Taking into account all forms of debt relief, the overall balance-of-payments situation improved from a surplus of $33 million in 1987 to a surplus of $95 million in 1988.

Because of a foreign exchange shortage, Reserve Bank approval was required for all foreign exchange transactions. With support from the IMF, World Bank, and bilateral donors, Malawi began an import liberalization scheme, effective February 1, 1988, which allowed commercial banks to approve foreign exchange requests for certain import categories, mainly raw materials for manufacturers and spare parts, without government clearance. The list of

liberalized goods was expanded August 8, 1988 to encompass 75 percent of goods used by Malawi industry. This has resulted in a significant improvement in manufacturing plant capacity utilization and a more favorable business climate. Malawi hopes to completely liberalize imports by March 1990.

Aside from the high transport costs, the 1988 current account deficit and expected deficit in 1989 are not worrying government, as the need to refurbish industry and restock raw materials is clearly fueling the current import growth. As long as foreign exchange reserves remain adequate, the government is confident Malawi will have time to reach a sustainable external trade balance.

EXPORTS: The value of Malawi's 1988 exports grew by 23.7 percent in local currency terms, although volume actually declined by 5 percent. The increased export value is due to larger tea exports, and higher tea and tobacco prices. Export volume is expected to decline by a further 2 percent in 1989 due to lower production of groundnuts and pulses. In 1988 tobacco accounted for $187.1 million of exports, tea $30.9 million, sugar $28.3 million, coffee $9.3 million, groundnuts $9.3 million, and other commodities $5.7 million. In 1987, the United States consumed 11 percent of Malawi's exports.

IMPORTS: In local currency, the value of 1988 imports jumped by 58.3 percent over 1987, while volume climbed by 32 percent. The large growth in imports reflects the release of pent-up demand following import liberalization. Import volume is forecast to climb at a much reduced rate of 3 percent in 1989. In 1987, industrial materials accounted for 38 percent of Malawi's imports, capital equipment 19 percent, intermediate and final commodities 15 percent, consumer goods 11 percent, and transportation equipment 9 percent. Outlays for fuel and fertilizer continued to be high in 1987, accounting for 11 and 10 percent of total imports, respectively. The United States had a 3 percent share of Malawi's import market in 1987.

DEBT: Due to Malawi's 1988 rescheduling of foreign debt at the Paris and London Clubs, the debt-service ratio was only 25.5 percent in 1988. This ratio is forecast to rise to 28.3 percent in 1989. Total external debt in 1988 was approximately $1,190 million, about 83 percent of annual GDP. Only 25 percent of Malawi's external debt is owed to London and Paris Club creditors The rest is owed to the World Bank, the IMF, the European Economic Commission (EEC), and the African Development Bank (ADB). Short-term arrears on supplier credits were completely eliminated in January 1988.

RESERVES: Foreign exchange reserves continued to swell throughout 1988, thanks to substantial disbursements from the World Bank under ITPAC, the IMF's ESAF, other donor co-financing, and lowered debt payments following the Paris Club rescheduling. Foreign exchange reserves totaled $138 million at the end of 1988, up from $39 million in December 1987. The December 1988 figure is equivalent to four months of imports. Malawi's foreign exchange reserves will probably remain healthy well into 1990.

FISCAL ISSUES: Following public sector expenditure overruns in 1986, a fiscal austerity program was introduced in August 1987, in consultation with the IMF and World Bank, to mobilize revenues and contain expenditures. Malawi's budget deficit was reduced to 5.5 percent of GDP in 1988/89, and is projected to rise only slightly in 1989/90 to 6.3 percent of GDP. Nominal government expenditures are scheduled to increase by 14 percent in 1989/90 over 1988/89 (not counting additional expenses due to the May 1, 1989 minimum wage increase). With inflation running at an annual rate of 26 percent in January 1989, budgeted expenditures will likely result in a 1989 real reduction in government spending even if the target of 12.5 percent inflation is quickly reached.

Parastatal performance has improved markedly since 1987. The total net surplus for the parastatal sector increased from $2.5 million in 1987 to $7 million in 1988. Of particular note is the healthy performance by the Agricultural Development and Marketing Corporation (ADMARC), which saw its net profit increase from $300,000 in 1987/88 to $3.6 million in 1988/89. Only four parastatals suffered losses in 1988/89: the Blantyre and Lilongwe Water Boards, Malawi Railways, and Wood Industries Corporation (WICO). The parastatal sector as a whole is expected to have a profit of $9.7 million in 1989.

MONEY SUPPLY: Malawi's broadest measure of money expanded by 35 percent in 1987 and 18 percent in 1988. As part of the policy to curtail monetary expansion and fight inflation, the government has restricted its domestic borrowing to the extent that substantial net repayment occurred in 1988 and is also scheduled for 1989. This should minimize the crowding out of the private sector in the domestic credit market. Reflecting this policy, net domestic credit fell by 22 percent in 1988, from $289 million to $225 million. This entire decline is due to reduced public sector demand, as domestic credit to the private sector actually rose by 28 percent, from $79 million to $102 million.

INFLATION: Malawi's inflation rate is an area of concern for both the government and IMF. For 1988, inflation was officially

31.5 percent. By January 1989, inflation had dropped to an annual rate of 26.2 percent. The Malawi Government hopes to reduce inflation to 12.5 percent by December 1989. The GOM fears continued high inflation will erode the export benefits of the 15 percent devaluation of the kwacha in January 1988 and derail the current economic expansion.

Among new powers allotted to the Reserve Bank, with an eye partly towards fighting inflation, are the authority to: a) supervise banks and other financial institutions; b) create monetary instruments in order to control credit and liquidity in the economy; c) conduct open market operations; and d) promote the development of a capital market.

EMPLOYMENT AND WAGES: Only about 10 percent of Malawi's working age population is engaged in wage employment. The number of paid employees decreased in 1987 to 407,393 from 427,834 in 1986. The largest declines were registered in the agricultural and manufacturing sectors. Although Malawi has a surplus of unskilled labor, there are acute shortages in professional and technical fields.

Effective May 1, 1989, the minimum wage was approximately doubled to $0.82 per day in the major cities, and $0.66 per day in the rural areas. This is the first minimum wage increase since 1986 and will almost cover the decline in real wages suffered since 1986. Employers primarily affected by the minimum wage increase are agricultural estates and the government.

PRODUCTIVE SECTORS

AGRICULTURE: Strengthening the agricultural sector, which provides 37 percent of GDP and over 90 percent of export earnings, is of primary importance to the government. The objective is to set relative price levels and provide research, extension, and credit services to smallholders so that cash crop production is expanded while food security (self-sufficiency in maize) is maintained. Smallholder farmers account for 77 percent of agricultural production and virtually all staple food crops. The estate subsector accounts for only 23 percent of production, but generates 90 percent of export earnings.

Overall, the agricultural sector expanded 3.7 percent in 1988, driven by increased production of maize and tobacco. In 1989, agricultural production is forecast to grow by 5.3 percent. The smallholder subsector is expected to expand by only 2.9 percent -- short of Malawi's 3.7 percent annual population growth rate.

However, heavy rains throughout Malawi during the first quarter of 1989, and severe March floods in various regions may have seriously affected Malawi's 1989 crops which will be harvested from March through June 1989. A drop in maize production, even to the level of the 1988 harvest (1.426 million tons versus the current 1989 estimate of 1.557 million), would directly reduce GDP growth by almost 1 percent.

MAIZE: Maize is Malawi's primary subsistence crop, and self-sufficiency is a national security objective. Drought conditions, combined with low producer prices relative to cash crops, caused production to decline to 1.21 million tons in 1987. Because of the drought, a mealy bug infestation of the cassava crop, and a burgeoning Mozambican refugee population (650,000 in April 1989), the 180,000 ton strategic grain reserve was exhausted in 1987, and Malawi was forced to turn to international donor assistance and maize purchases from abroad. In 1988, production increased to 1.427 million tons, which combined with donor maize, allowed Malawi to start rebuilding its grain reserve. All refugee maize requirements are provided by the donor community.

In 1988, the producer price for maize was increased to 240 kwacha per ton from 167 kwacha per ton in 1987. Although the 1988 uptake of fertilizer has led the Malawi Government to estimate 1989 maize production of 1.557 million tons, heavy rainfall and flooding has cast doubt on estimates of increased production. The introduction of private trading in 1987 and the parallel reduction of ADMARC's share of maize purchases have complicated Malawi's estimation of annual maize production.

TOBACCO: Tobacco exports accounted for 63 percent of Malawi's 1988 export earnings. The heavy 1989 rains have also been detrimental to the quality of the tobacco crop, resulting in lower prices at the beginning of the auction season in April 1989. Tonnage for burley tobacco, however, is estimated to have increased 11 million kg over 1988 to between 55 and 58 million kg. Flue-cured tobacco production is expected to remain static at 21 to 22 million kg, while production of oriental and fire-cured tobaccos is expected to again fall short of demand, reaching perhaps seven million kg.

TEA: Earnings in 1988 improved markedly over 1987, both from production increases and firmer auction prices. Production increased 26 percent from 31.9 million kg in 1987 to 40.1 million kg in 1988, and a further increase is anticipated for 1989.

SUGAR: Sugar was Malawi's third largest export earner in 1988, with production increasing from 167,730 tons in 1987 to 170,000 in 1988. Improved world market prices and a slightly increased U.S. quota contributed to increased earnings. Spot sales to countries in the region have proved very profitable, so much so that smuggling is contributing to periodic and regional shortages in Malawi. Although production increases for 1989 are anticipated, flood damage to the sugar estates has yet to be evaluated.

COFFEE: Coffee is an increasingly important export crop for Malawi, which produced 4,320 tons of mild arabica in 1988. This is 13 percent lower than the 1987 crop of 4,966 tons. Coffee has overtaken groundnuts as Malawi's fourth leading export.

TRANSPORTATION: Difficulties with the external land transportation network are among the most serious constraints to Malawi's economic development. The ADB estimates Malawi ranks number two in the world for the most expensive external transportation routes. Recent estimates indicate that excess costs due to an inability to use the rail lines through Mozambique will cost Malawi over $100 million in 1989, up from $75 million in 1988. This is equivalent to 34 percent of the country's export earnings.

Before 1981, over 90 percent of Malawi's imports and exports moved by rail through the Mozambique ports of Beira and Nacala. Traffic via these routes has been virtually halted since April 1984 as a result of insurgent activities and the consequent physical deterioration of the rail lines and rolling stock. Even if the problem of insurgency in Mozambique were overcome, it would take some time and substantial financial resources to restore the level of operations once enjoyed by both lines.

The virtual closure of overland routes through Mozambique has precipitated dramatic changes in Malawi's pattern of trade and traffic. The vast majority of Malawi's overseas trade has been diverted to the South African port of Durban, which can only be reached by long routes through Zambia or Mozambique and Zimbabwe or Botswana. The bulk of the traffic is convoyed through Tete Province, Mozambique under escort by Zimbabwean army units and on to Harare. The adverse impact of this diversion on import prices, export profits, and the balance of payments has been substantial.

This situation has forced Malawi to explore alternative routes to the sea which avoid the high cost and susceptibility to sanctions of the Durban routes. While still subject to insurgent attacks, improvement of the "Beira Corridor," a rail, pipeline, and road link from Harare to Beira has provided some relief.

The only alternative to the Mozambican ports and the costly Durban outlet is the Tanzanian port of Dar es Salaam (via the Northern Corridor), which currently handles about 7 percent of Malawi's trade. The major advantages of the Northern Corridor are the added security of an alternative transportation route and the competitive pressure exerted on existing routes. USAID is a major participant in the $100 million, multidonor upgrade of this route. Completion, however, is unlikely before 1990 or 1991.

Since the distances involved are significantly longer than the traditional routes through Mozambique, Malawi will not see a return to more reasonable traffic costs until the Nacala and Beira routes are reopened. In December 1986, Malawi and Mozambique agreed to reopen the Nacala line which has been out of service since 1984. Under the agreement, Malawi provides military protection for the line from Malawi's border to Malema. The line is currently almost complete, and limited operations may commence later in 1989.

MANUFACTURING: Malawi's small manufacturing sector is geared primarily to import substitution of basic commodities (clothing, food, beverages, and metal fabrication) and processing of agricultural products (tobacco, tea, sugar, maize, oil seeds, groundnuts, and macadamia nuts). The country imports all of its petroleum requirements as well as many of the raw materials and intermediate inputs for the small manufacturing sector.

Manufacturing accounted for 12 percent of GDP in 1988, roughly the same percentage as the past five years. Increased agricultural production and improved access to foreign exchange led to a 6.5 percent increase in the industrial production index in 1988, following a 4 percent decline in 1987. Output is forecast to grow by 4.9 percent in 1989, as capacity utilization increases from a low of 20 percent at the beginning of 1988 to 75 percent in 1989. In December 1988, capacity utilization stood at 50 percent.

ENERGY/MINING: Reflecting the rural nature of Malawi's economy, two-thirds of Malawi's effective energy utilization comes from firewood and charcoal. Petroleum (14 percent), hydroelectricity (14 percent), and coal (6 percent) account for the rest. All petroleum products are imported, costing $40 million in 1988. Gasoline is mixed with locally produced ethanol, with a targeted 80:20 ratio. Malawi's northern Kaziwiziwi and Mchenga mines produced 26,140 tons of subbituminous coal in 1988, 62 percent of total demand. However, known reserves at these mines are only sufficient to last another three to five years. Consequently, French-sponsored exploration of coal outcrops in the southern region has increased.

DONOR ASSISTANCE: Malawi is very dependent on western donors to implement its national development program and accomplish economic structural adjustments. Concessional assistance levels have averaged more than $200 million annually over the past several years, and these levels are expected to be maintained due to Malawi's economic needs and the government's image as a prudent manager of external and domestic resources.

The principal donors to Malawi are the UN, World Bank, Japan, West Germany, EEC, United Kingdom, United States, and the ADB. The principal areas of assistance are economic and fiscal reform, transportation, private sector expansion, agricultural and rural development, and health and population.

Part B - IMPLICATIONS FOR THE UNITED STATES

The most promising area for U.S. firms wishing to export to Malawi is in the supply of materials and equipment required for bilateral and multilateral development projects. Bids of U.S. origin are specifically encouraged for projects funded by the U.S. Agency for International Development (USAID), the World Bank, and the African Development Bank/Fund.

There is also a large demand for all manner of imports to Malawi which have been bottled up by foreign exchange limitations. Although demand for South African and U.K. products is predominant, various importers have recently expressed interest in reviewing U.S. products in light of past dollar depreciations against major European currencies. Imports of U.S. heavy trucks, for example, have benefitted from the cheaper dollar relative to the British pound. Opportunities exist for the sale of equipment and materials used in the country's small agro-industrial sector, and electronic goods, including computers and word processing equipment.

INVESTMENT CLIMATE AND OPPORTUNITIES: Investment opportunities have been emerging within the parastatal sector as government-owned corporations seek to rationalize their operations and attract the capital and management expertise required to enable them to become profitable.

The policy of the Malawi Government is to encourage private enterprise and support market-oriented capitalism. At the same time, cooperation between the public and private sectors is frequent and large joint ventures between parastatal companies and private entities are common. Establishment of new firms is controlled by licensing requirements specified by the Industrial Development Act. License applications are expedited for prospective agro-industrial investors.

Malawi seeks foreign investment and, to that end, maintains a liberal investment system. Royalties, dividends, profits, loan capital, and a portion of personal earnings may be repatriated without restriction, although clearance through the exchange control authority is required. Equity capital repatriation is also subject to exchange control authority. Investors are allowed to retain 4 percent of foreign exchange earned. There are no laws or regulations mandating reinvestment of any portion of profits in Malawi.

Investment incentives are offered through tax concessions: a 40 percent investment allowance on industrial buildings, plant and non-road transport items; or a 10 percent initial allowance and 10 percent allowance on capital expenditures incurred during the 18 months prior to commencement of operations. There are also depreciation allowances; import duty exemption on plant and equipment; and deduction for land improvement and conservation in agricultural investments. The net result of the incentive system is that a new investor generally pays little or no local taxes for the first few years of operation. In exceptional cases, investors may be granted exclusive production rights and tariff protection. The United States has an Overseas Private Investment Corporation (OPIC) agreement with Malawi and several U.S. companies use OPIC coverage.

Several industrial projects are under consideration, including a fertilizer plant and hydroelectric projects. The expanding tourist industry offers potential for investment in new hotels and recreational areas. Furthermore, the privatization of companies owned by ADMARC could be of interest to potential U.S. investors.

Personal contact is essential when competing in the Malawi market. A visit to Malawi as part of a Southern Africa regional trip would, therefore, be useful. Commercial visitors are invited to visit the Embassy while in Lilongwe. The Embassy staff will make every effort to facilitate local contacts and provide current economic and commercial information.